THE CITY OF SAN DIEGO

MANAGER'S REPORT

DATE ISSUED: February 4, 2005 REPORT NO: 05-035

ATTENTION: Honorable Mayor and City Council
Docket of February 14, 2005

SUBJECT: Participation in Vehicle License Fee Gap Receivables Financing Program

SUMMARY

Issues: - Should the City Council:

Adopt a resolution authorizing and approving: (a) the sale of the City's VLF Receivables to the California Statewide Communities Development Authority ("CSCDA") for a minimum sale price equal to $20.0 million; (b) the execution and delivery of the Purchase and Sale Agreement with CSCDA and related documents; (c) the City Manager or his designee to send an irrevocable written instruction required by statute to the State Controller notifying the State of the sale of the VLF Receivables and instructing the disbursement of the VLF Receivables to the VLF Note trustee; (d) the use of the VLF Receivables proceeds to pay down a majority of the outstanding principal and accrued interest on the Open Space G.O. Refunding Bonds, Series 1994; (e) the City Manager or his designee to take any and all related actions necessary in connection with the VLF Gap Receivables Financing Program participation; and (f) all consents, approvals, notices, orders, requests and other actions permitted or required by any of the documents authorized by the Resolution, whether before or after the sale of the VLF Receivable or the issuance of the Notes, may be given or taken by the City Manager or his designee without further authorization by City Council.

Manager's Recommendations:

Adopt a resolution authorizing and approving: (a) the sale of the City's VLF Receivables to the California Statewide Communities Development Authority ("CSCDA") for a minimum sale price equal to $20.0 million; (b) the execution and delivery of the Purchase and Sale Agreement with CSCDA and related documents; (c) the City Manager or his designee to send an irrevocable written instruction required by statute to the State Controller notifying the State of the sale of the VLF Receivables and instructing the disbursement of the VLF Receivables to the VLF Note trustee; (d) the use of the VLF

Receivables proceeds to pay down a majority of the outstanding principal and accrued interest on the Open Space G.O. Refunding Bonds, Series 1994; (e) the City Manager or his designee to take any and all related actions necessary in connection with the VLF Gap Receivables Financing Program participation; and (f) all consents, approvals, notices, orders, requests and other actions permitted or required by any of the documents authorized by the Resolution, whether before or after the sale of the VLF Receivable or the issuance of the Notes, may be given or taken by the City Manager or his designee without further authorization by City Council.

Other Recommendations: None

Fiscal Impact: The State-local agreement, as described below, provides for the repayment of approximately $1.2 billion (VLF Gap Repayment) by the State to local governments. The agreement requires the payment to be made to local governments by August 15, 2006, but it is possible that the State could delay such repayment beyond this date. The City of San Diego's share of the VLF Receivables is approximately $21.6 million. However, if the City elects to participate in the VLF Program, discussed herein, it would receive a minimum amount of approximately $20.0 million in March 2005. The difference between the two totals, $1.6 million, is an aggregation of: approximately $1.4 million in capitalized interest on a taxable basis on the VLF Notes, $150,000 in credit enhancement costs, and $100,000, pro-rata portion of the administration fees related to the issuance of the notes to be paid to CSCDA.

The City could utilize the estimated $20.0 million in proceeds, combined with, as of March 2005, approximately $3.7 million in the Environmental Growth Fund designated for the payment of debt service on the Series 1994, General Obligation (G.O.) Bond Refunding, to pay down approximately 90% of the outstanding principal and accrued interest on the Open Space G.O. Refunding Bonds, Series 1994. Upon paying down approximately $23.7 million principal and accrued interest amount, the remaining principal on the Series 1994 G.O. Bond Refunding Bonds will carry an annual debt service obligation of approximately $715,000 for FY06- FY09. Presently, the annual debt service obligation on these bonds is $7.4 million, approximately $6.7 million higher than the future estimated debt service, upon paying down $23.7 million in principal and accrued interest in March 2005. This results in an aggregate reduction of approximately $26.9 million in debt service over the remaining four years (FY06 – FY09).

BACKGROUND

The vehicle license fee (VLF), also called the motor vehicle in-lieu tax, is a tax on the ownership of a registered vehicle in place of taxing vehicles as personal property. The VLF is paid annually to the localities upon vehicle registration and funds specific State programs, city services, and county services. The vehicle license fees were historically assessed in the amount of 2% of a vehicle's depreciated market value for the privilege of operating a vehicle on California's public highways. Proposition 47 of 1986 (Article XI, Section 15 of the California State Constitution) requires that the VLF is allocated to cities and counties; however, the legislature may alter the tax rate and the allocation among cities and counties.

Beginning in 1999, the VLF paid by vehicle owners was offset (or reduced) from 2% to the effective rate of 0.65%. In connection with the offset of the VLF, the State Legislature authorized appropriations from the State General Fund to "backfill" the offset so that local governments, which receive all of the vehicle license fee revenues, would not experience any loss of revenues. The legislation that established the VLF offset program also provided that if there were insufficient State General Fund moneys to fully "backfill" the VLF offset, the percentage offset would be reduced proportionately (i.e., the license fee payable by drivers would be increased) to assure that local governments would not be disadvantaged.

In June 2003, the Director of Finance under the Davis Administration ordered the suspension of VLF offsets due to a determination that insufficient State General Fund moneys would be available for this purpose, and, beginning in October 2003, the VLF paid by vehicle owners were restored to the 2% level. However, the offset suspension was rescinded by Governor Schwarzenegger on November 17, 2003, and State offset payments to local governments resumed. Local governments received "backfill" payments totaling $3.80 billion in FY 2002-03 and payments totaling $2.65 billion in FY 2003-04. However, approximately $1.2 billion was not received by local governments during the time period between the suspension of the VLF offsets and the implementation of higher fees and is still owed them by the State (the "VLF Gap Repayments"). The City's share of the VLF Gap Repayment is approximately $21.6 million expected to be due in August 2006.

DISCUSSION

Participation in CSCDA Financing

As part of the 2004 Budget Act negotiations, an agreement was made between the State and local government officials (the "State-local agreement") under which the VLF rate will be permanently reduced from 2% to 0.65%. The State-local agreement also provides for the repayment by August 15, 2006 of approximately $1.2 billion VLF Gap Repayment but it is possible that the State could delay such repayment beyond the August 15, 2006 date. In order to protect local governments, the reduction in VLF revenue to cities and counties from this rate change will be replaced by an increase in the amount of property tax they receive. Under the State-local agreement, for FY 2004-05 and 2005-06 only, the replacement property taxes that cities and counties receive has been reduced by $700 million. Commencing in FY 2006-07, local governments will receive their full share of replacement property taxes and those replacement property taxes will now enjoy constitutional protection against transfers by the State due to the approval of Proposition 1A at the November 2004 election.

Authorized under SB 1096, the VLF Gap Receivables Financing Program was instituted by the California Statewide Communities Development Authority ("CSCDA") in 2004 to enable cities and counties to sell their respective VLF Receivables to CSCDA for an upfront fixed purchase price between 90-96% of their share of VLF Gap Repayment. CSCDA is a joint powers authority sponsored by the League of California Cities and the California State Association of Counties. The member agencies of CSCDA include approximately 230 cities and 54 counties throughout California, including the City of San Diego. On behalf of local entities, CSCDA is coordinating a pooled financing to issue "VLF Notes" enabling CSCDA to use note proceeds to purchase local entities' VLF Receivables and fund certain financing costs. The tax-exempt option is only available to entities that can demonstrate that the sale proceeds will be spent on tax-exempt uses, such as refunding outstanding bonds. The actual purchase price of the VLF Receivables will depend on the total amount of VLF Receivables that cities and counties sell to CSCDA and on bond market conditions at the time the VLF Notes are priced. If the City sells its VLF Receivables under the VLF Program to CSCDA, CSCDA will in turn pledge the City's VLF Receivables to secure the repayment of a corresponding portion of the VLF Notes. The City's sale of its VLF Receivables to CSCDA is irrevocable and note-holders will have no recourse to the City if the State does not make the VLF Gap Repayment in Fiscal Year 2007 or thereafter.

It is currently estimated that the transaction size sponsored by CSCDA will be in excess of $100 million and will have both a tax-exempt and taxable series, with an all-in financing cost of 3.41% and 4.88%, respectively. Presently, approximately 135 California localities including the County of San Diego, the City and County of Riverside have indicated their intention to participate in the VLF Program. The final repayment term of the VLF Notes to the note holders will be November 2006, past the August 15, 2006 anticipated repayment date of VLF loan by the State, in order to cover a possible delay in the repayment by the State. It is estimated that CSCDA will issue approximately $21.6 million of VLF Notes to purchase the City's VLF Receivables. Of this amount, the City will receive a minimum of approximately $20.0 million in proceeds, with the remaining amount being utilized for capitalized interest and to pay certain other costs in connection with the financing. These VLF Notes will be tax-exempt, with the exception of a taxable capitalized interest portion; CSCDA bond counsel for this transaction has advised that under existing tax law, capitalized interest is not a permitted use of tax-exempt proceeds when refunding outstanding bonds.

It is proposed that the City utilize the VLF Receivable proceeds purchased on a tax-exempt basis to pay down a majority of the outstanding debt on the Open Space G.O. Refunding Bonds, Series 1994. The Open Space G.O. Refunding Bonds, Series 1994, were issued with a 10 year call provision. The bonds can be called on or after Jan. 1, 2004 without having to pay a premium price. As of March 2005, $25.9 million in principal will be outstanding on the Open Space G.O. Refunding Bonds. The Indenture associated with the G.O. Bond Refunding issuance allows for a partial redemption of the bonds, therefore the City could apply the estimated $20.0 million in VLF proceeds plus $3.7 million in cash funds from the Environmental Growth Fund, to pay off a portion of the outstanding principal (approximately 90%), plus accrued interest. The annual debt service on the remaining principal balance, would be approximately $715,000, $6.7 million lower than the current debt service on these bonds, or an aggregate reduction of $26.9 million over the remaining four years (FY06 – FY09). Final maturity on these bonds is in Fiscal Year 2009. Any annual debt service savings from paying off Open Space G.O. Refunding bonds will be limited to the Environmental Growth Fund uses and open space related activities per the City Charter section 103.1a and Municipal Code section 63.30.

Estimated Amount of Proceeds from the Sale of the City's VLF Receivables

Upon delivery of the VLF Notes, CSCDA will make available to the City its fixed purchase price by depositing the sale proceeds with the VLF Note trustee for requisition by the City for the tax-exempt uses described above. As discussed above, the City's VLF Receivables is approximately $21.6 million, and the purchase price to be paid by CSCDA is estimated to be $20.0 million. The amount of net proceeds to be received by the City cannot be determined with specificity until the total size of the transaction is determined which is dependent on the number of participants in the VLF Gap Program and the interest rate conditions at the time the VLF Notes are priced.

CONCLUSION

It is recommended that the City Council adopt the proposed resolution authorizing and approving the sale of the City's VLF Receivables to CSCDA, approve the form, and direct the execution and delivery of the Purchase and Sale Agreement with CSCDA and related documents, authorize and direct the City Manager or his designee to send an irrevocable written instruction required by statute to the State Controller notifying the State of the sale of the VLF Receivables and instructing the disbursement of the VLF Receivables to the VLF Note trustee, approve the use of the VLF Receivables proceeds to pay down outstanding debt on the Open Space G.O. Refunding Bonds, Series 1994, authorize the City Manager or his designee to take any and all actions necessary in connection with the VLF Gap Program participation, and authorize all consents, approvals, notices, orders, requests and other actions permitted or required by any of the documents authorized by the Resolution, whether before or after the sale of the VLF Receivable or the issuance of the Notes, may be given or taken by the City Manager or his designee without further authorization by City Council.

ALTERNATIVE

Do not approve the resolution authorizing the sale of the City’s VLF Receivables.

Respectfully submitted,

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CHARLES E. MUELLER, JR.	Approved: LISA IRVINE
Acting City Treasurer	Deputy City Manager

MUELLER/LK/JW/RD